No. 782

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

ALFRED YOUNG CHICK, ET AL,
APPELLANTS,

vs.

THE MERCANTILE TRUST COMPANY. ET AL,
APPELLEES.

APPELLANTS' BRIEF.

GEORGE E. CHURCH,
L. A. GROFF,
JOHN D. WORKS,
BRADNER W. LEE,
LEWIS R. WORKS,
Counsel for Appellants.

Dated, January, 1902. *Clerk*

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A. Y. CHICK, et al,
Appellants,

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MERCANTILE TRUST COMPANY, et al,
Appellees,

APPELLANTS' BRIEF.

This is a suit to foreclose a trust deed given to secure the payment of the bonds of the defendant company. The suit was brought by the trustee. The defendant company interposed no defense, but appeared, admitting the allegations of the bill to foreclose, and the president of the company was, by agreement of the parties, appointed receiver pending the foreclosure.

Subsequently, A. Y. Chick, et al, filed their petition for leave to intervene, setting up that they are owners of $38,000 of the bonds secured by the trust deed sued on; that the foreclosure of the trust deed was wholly unnecessary, and would result in a sacrifice of the property; that the said mortgage was being foreclosed, not for the purpose of collectng the money due the bondholders, but to bring about a re-organization of

the defendant company in the interest of a part of the bondholders, who had instigated the suit, and that the plan of reorganization, copy of which was made part of the petition, provided for the delivery of $100,000 of the stock of the reorganized company to the president and engineer and general manager of the defendant, in consideration of their facilitating the foreclosure.

The Court granted the petition for leave to intervene, (Record p. 59) and a bill of intervention was filed. (Record p. 60.) In this bill, in addition to the affirmative matters set up in the petition, which were included in the bill, certain allegations of the bill of complaint, including the allegations that the trustee had been requested by a majority of the bondholders to bring suit to foreclose the mortgage or trust deed, were denied. A motion was made to strike out these denials and all of the matter in the bill in intervention that purported to be or amounted to an answer to the bill of complaint. This motion was sustained, and all of the matter indicated stricken out. (Record p. 77), the Court holding that all we could do under our bill in intervention was to take evidence in support of our allegations tending to show collusion and want of good faith in bringing the action, thus showing the *right* of the bondholders to intervene and protect their own interests. This was in effect requiring us to prove the facts in support of our petition for leave to intervene, that had already been granted, and denied us the right to do what we intervened for, viz.: make proof against the foreclosure of the mortgage. This was to hold, in effect, that if we made proof establishing the necessity for the complaining bondholders to intervene, *then* they might plead in answer to the bill.

The evidence was taken upon the issues as thus formed upon the bill in intervention with all of the defensive matter con-

tained therein stricken out, thus depriving the intervenors, after having become such by order of the Court, of all right to prove any fact that would defeat the foreclosure of the bonds.

The following errors are assigned:

1. That the Circuit Court of the United States, Ninth Circuit, Southern District of California, erred in striking out from the bill in intervention of the appellants, on motion of the complainant, the following:

"Your intervenors further show to your Honors as follows: They admit that on or about the 1st day of July, 1895, the defendant made, executed and issued its certain sixteen hundred (1600) bonds, each for the principal sum of Five Hundred Dollars ($500.00) and for the principal sum in the aggregate thereof of Eight Hundred Thousand Dollars ($800,000.00), each bearing date the 1st day of July, 1895, wherein and in each of said bonds the said defendant, for value received, promised to pay to the bearer the sum of Five Hundred Dollars ($500.00) in Gold Coin of the United States of America, of the then standard of weight and fineness, on the 1st day of July, 1915, at the office of the complainant, in the City of New York, together with interest thereon at the rate of six (6) per cent. per annum, payable semi-annually in like gold coin, on the 1st days of January and July in each year, on presentation and surrender of the interest coupons attached to said bonds, as they severally should become due, said interest also being payable at the office of said complainant.

They admit that in order to secure the payment of the principal and interest of said bonds, the said defendant, on or about the 1st day of July, 1895, made, executed and delivered to the complainant as trustee a certain mortgage or deed of trust, dated on that day, wheren and whereby it granted, bargained, sold, assigned, set over, released, aliened, conveyed

and confirmed unto said complainant and its assigns and successors, in trust, for the purposes in said mortgage set forth, the property described in the third paragraph of the bill of complaint herein, to have and to hold all such property and all other possession, franchises and claims acquired or to be acquired, and all other premises in said mortgage expressed to be conveyed and assigned unto the use of said complaint and its successors in interest, according to the manner, terms and effect in said mortgage expressed of and concerning the same, for the benefit, protection and security of the persons holding the said bonds, or any of them; that said mortgage or deed of trust was duly recorded in the proper offices in the Counties in which the property described therein and thereby conveyed, or intended so to be, was situated, a copy of which mortgage is annexed to and made a part of the bill of complaint herein.

They admit that of the bonds provided to be issued under and secured by said mortgage or deed of trust, or intended so to be, eleven hundred ten (1110) bonds, numbered from one (1) to eleven hundred ten (1110), inclusive, for the principal sum in the aggregate of Five Hundred Fifty Thousand Dollars ($550,000.00), were duly executed and issued by the said defendant, and were certified by said complainant as trustee under said mortgage or deed of trust, and that the same are now outstanding in the hands of *bona fide* holders thereof for value.

They admit that in and by the said mortgage or deed of trust it was, among other things, provided that in case the said defendant or its successors should make default in the payment of any interest on any of said bonds, according to the tenor thereof, the payment thereof having been demanded according to the terms thereof, or should make a breach of any of the covenants or agreements in said mortgage contained by it to be done or performed, and such default or breach

should continue for the period of six (6) months, that then and thereupon the principal of all of said bonds then outstanding and unpaid might, at the election of the trustee, or at the request of one-tenth (1-10) of the amount of bonds then outstanding and secured thereby, become immediately due and payable.

They admit that in and by said mortgage or deed of trust, it was further provided that if the defendant or its successors should make default in the payment of the principal or any part thereof, or any installment of interest, or any part thereof, and such default should continue for the space of six (6) months after maturity and demand therefor, it should be the duty of the trustee, upon request and indemnification in said mortgage provided, to proceed in any proper court to foreclose said mortgage, and that the said trustee, the complainant herein, should be entitled to the appointment of a receiver and specific performance of all the covenants therein contained, and said trustee might, in case of default, apply to any court having competent jurisdiction, for instructions as to the matters not therein expressly provided for.

They admit that on or about the 1st day of January, 1899, there fell due a semi-annual installment of interest upon said bonds represented by the coupons attached thereto, amounting to the sum of Sixteen Thousand, Six Hundred Fifty Dollars ($16,650.00), which amount of interest the defendant refused and neglected to pay; but deny that payment thereof was duly or at all demanded, and that a like default occurred on the 1st day of July, 1899; but your intervenors allege that said default was the result of collusion between the said defendant and its officers in charge of its business, and the holders and owners of certain of the bonds of said defendant, and the same owners and holders of bonds who have caused this suit to be instituted, and for the purpose of bringing about an un-

necessary re-organization of said Company and its affairs, to the detriment of your intervenors and other of the bondholders of said defendant not parties to said collusion or scheme of re-organization; and they further aver that the said defendant was fully able to pay the said installments of interest, as they fell due, out of the earnings and funds of said Company, and that no proper demand for the payment of said interest was ever made.

They admit that the said default continued for a period of more than six (6) months, but deny that the complainant was requested by the holders of more than a majority of the bonds outstanding and secured by said mortgage or deed of trust, or intended so to be, under the power and authority given to it by said mortgage or deed of trust, to declare, or that the complainant elected or declared that the principal of all the bonds then outstanding and unpaid should become immediately due and payable, or that it served notice of such election upon the defendant.

They deny that the defandant, San Joaquin Electric Company, is insolvent, or wholly or at all unable to pay its present or presently accruing indebtedness or liabilities, or the interest on said bonds now due, or that the property covered by the said mortgage or deed of trust, or intended so to be, is slender or insufficent security for the payment of said indebtedness.

They deny that in addition to the amount represented by the said bonds and coupons, the said defendant is indebted to sundry or diverse persons in large sums, which debts, or any of them, have been incurred in the operation of the business of the said defendant, or which debts the said defendant is wholly or at all unable to pay.

They deny that by reason of the insolvency of the said defendant, or for any other reason, it is necessary for the proper protection of the holders of the bonds and coupons secured by

the mortgage or deed of trust given to the complainant, as aforesaid, that a receiver or receivers of the property of the said defendant, San Joaquin Electric Company, should be appointed, with the powers given to such receiver or receivers in like cases under the course and practice of this court, or at all.

They admit that the matter in controversy herein exceeds five thousand dollars ($5,000.00), exclusive of interest and costs."

2. Said Court erred in dismissing the bill in intervention of the appellants in said action.

3. Said Court erred in holding that the evidence in the matter of the intervention of the appellants did not connect the complainant with the proposed scheme of reorganization, as alleged in their bill of intervention.

4. Said Court erred in holding that the testimony of the witness Coffin as to the said scheme of reorganization, and the knowledge therof on the part of the complainant, was hearsay.

5. Said Court erred in holding that there was no fraud or collusion between Seymour and Eastwood, officers of the defendant, San Joaquin Electric Company, and the bondholders at whose request said suit was commenced and prosecuted, with regard to the proposed reorganization of said defendant Company.

6. Said Court erred in holding that the default in payment of interest by the defendant Company, as alleged in the bill of complaint, was not on account of collusion between the officers of the defendant and the bondholders by whom said foreclosure proceedings were brought about, or their repesrentatives.

As the case is now presented, the following questions are material:

1. Did the Court below err in striking out the portions of

the bill in intervention set out in the assignments of error?

2. Was the Company insolvent when the right to foreclose accrued?

3. Was there, or is there now, any necessity for the foreclosure of the trust deed for the protection of the bondholders?

4. Was there a plan and scheme to reorganize the Company and to foreclose the trust deed for that purpose, without regard to the necessity for such foreclosure for the protection of the bondholders?

5. Were the officers of the defendant Company, or any of them, parties to the scheme to reorganize?

6. Did such officers, in view of such proposed reorganization and the benefits to accrue to them thereby, allow the continued defalcation of more than six months, when they could have avoided it by paying the semi-annual interest charge maturing January 1, 1899, and which might have been paid at any time before June 1, 1899, and a foreclosure thereby prevented?

We will discuss these several questions separately.

I.

The Court below erred in striking out portions of the Bill in Intervention.

The intervenors had made their application regularly to intervene in the case, setting up as the reasons therefor that there was no necessity, in the interest of the bondholders, to foreclose the trust deed, and that such foreclosure had been brought about, and was being prosecuted by certain of the bondholders, for the sole purpose of bringing about a sale and sacrifice of the property described in the trust deed, and the acquisition thereof by the said bondholders, in opposition to the interests of the bondholders as a whole. The right to intervene was granted by order of the Court.

Record p. 59.

This being done, the intervenors became practically defendants to the acton. They were thus entitled to make any defense to the foreclosure of the trust deed that might have been made by any party made defendant to the bill originally. If not, there was no reason for making them parties at all. The issue as to whether they were entitled to intervene or not was presented by their petition for leave to intervene.

This issue having been passed upon in their favor, and they having been made parties to the suit, they had the undoubted right to plead any matter in their bill in intervention that would defeat the action on the part of the complainant. This being so, it was clearly error on the part of the Court below to strike out from the bill in intervention the allegations therein denying matters alleged in the bill material to the right of the complainant to recover. One of these was the denial of the fact that a request had been made upon the trustee complainant by the requisite number of bondholders to bring the suit. The allegation was a material one, and affected directly, not only the defendant in the action, but the minority bondholders whose rights were attempted to be protected by this very provision in the trust deed, that no suit should be brought by the trustee except upon the request of the number of bondholders named. There were other equally material averments in the bill that were put in issue by the portion of the bill in intervention stricken out by the Court. These parts of the bill having been stricken out, of course the intervenors made no proof in support of those allegations or denials in their bill in intervention. Notwithstanding this, the complainant undertook to show by one of the officers of the defendant trustee that such request had been made by the requisite number of bondholders. The evidence was clearly immaterial on their behalf, the intervenors having been deprived of the right to

make and sustain that issue by the striking out of that portion of their bill in intervention denying the allegation of such request. We respectfully submit that if there were no other question involved in this case, the decree of the Court below should be reversed on this ground alone.

II.

Was the Company insolvent when the right to foreclose accrued.

The question as to the insolvency of the Company must necessarily relate to the end of the six months after the first default in interest occurred, which would be July 1, 1899. The other side have treated the question as if it related to the time of the defalcation, which would be January 1st of that year. But no right of foreclosure could accrue to the bondholders until the defalcation had occurred and had continued for six months. Therefore, if the Company was solvent at that time, it is of no consequence whether it was so six months earlier or not. That this Company was solvent at the end of the six months, and could easily have paid the half yearly interest charge that fell due on January 1, 1899, before the end of the six months that entitled the trustee to foreclose the trust deed, there can be no sort of question. The figures demonstrate that fact beyond any doubt.

The testimony of Mr. Coffin, who was formerly a stockholder and officer in the Company, contains statements furnished him by the Secretary of the Company. Those statements can not be set out here, but Mr. Coffin's summing up of them shows the condition of the Company. With respect to the condition of the finances of the Company, he says:

"Q. From the figures shown in the statements furnished you of the condition of the Company *on July 1st or June 30th,*

1899, do those figures show the Company to be solvent or insolvent?

A. They show the Company to be solvent.

Q. Can you state on what you base your judgment as to the solvency of the Company?

A. The balance sheets submitted monthly, together with the statements in evidence show the Company to have a surplus income in excess of its expenses for the six months from January 1, 1899, to June 30, 1899, of $42,328.16.

Q. How much would it have required during that period to have met the interest on the bonds and to have prevented a foreclosure?

A. $26,250.00.

Q. What surplus would that leave over and above the amount required to meet the interest on the bonds?

A. $16,078.16."

Record p. 163.

In addition to this, he testified that Mr. Street told him, after an investigation of the condition of the Company, just before the reorganization scheme was agreed upon, that the Company was solvent.

Record p. 164.

If we look to the figures given by the Secretary of the Company, Mr. Collier, in his deposition, the same result will be obtained. His testimony shows that the Company earned the following surplus revenues, after paying all of its debts, not including the interest:

For the year 1897.....$10,878.80
For the year 1898..... 14,172.49,
For the year 1899..... 29,957.28,

making a total of surplus earnings for those years $55,008.57.

Record pp. 243, 244, 249, 305.

When asked what was done with that surplus revenue, the witness answered that it had been expended in construction. But the evidence shows, and that is an undisputed fact in the case, that the Company paid its interest on the bonds for 1897, and for the first half of 1898. Taking the semi-annual inter-

est charge, the amount would be $15,750.00. That was the amount falling due on January 1, 1899, and which must have been paid on or before July 1, 1899, in order to prevent a foreclosure. For that year, the surplus revenues of the Company were $14,173.49, as above stated. The half of that earned after the first half year's interest was paid would be half of the amount, or $7,086.74. If that had been applied, as it should have been, to the payment of the interest, there would have been but $8,663.26 still due. The evidence shows, as above stated, that for the year 1899 the surplus revenue was $29,957.28. Taking half of that for the six months within which the interest must be paid to prevent a foreclosure, the Company had earned a surplus revenue of $14,978.64. That was only $771.36 less than enough to pay that entire half year's interest. But as we have shown above, there was earned for the previous six months, a surplus revenue of $8,663.26, that was carried over, and should have been applied to the interest; so that the officers of the Company, if they had desired, could have paid all of the interest, and had remaining a surplus of $7,891.90 to be applied on the next half year's interest. With that $7,891.90, with the surplus earnings for the last half of the year 1899, viz: $14,978.64, the Company would have had a surplus of $22,870.54 with which to pay the half year's interest amounting to $15,750.00, and would, as the figures show, have had a large surplus to carry over into the year 1900, viz: the difference between $22,870.54 and the half year's interest.

There is no questioning these figures. They are admitted to be the actual earnings of the Company. The whole trouble is that this reorganization scheme, to be hereafter mentioned, intervened between the time the interest fell due and the end of the six months when it might have been paid, and by that intervention, the officers of the Company were offered a scheme

for permitting the foreclosure to take place. If we look to the accounts presented on behalf of the complainant, as testified to by their expert bookkeeper, Niven, it will be perfectly plain to the Court that the purpose of that account was to show the Company to be insolvent. It does not relate, however, to the proper time. It relates exclusively to the condition of the Company on the 31st day of December, 1898.

Record p. 323.

It does not take into account the increased revenues of the Company from $14,173.49 for the year 1898, to $29,957.28 for the year 1899, which would have shown that the revenues of the Company were increasing to such an extent that the interest could easily be paid. And in addition to this, in order to make the account appear as badly as possible, the account on the debit side has $11,000 charged up to depreciation, and also in the account of liabilities has $22,688.22 of indebtedness charged up as due the Fresno Water Company; neither of these items, which amount to $33,688.22, should have been carried into the account. The evidence shows that the Fresno Water Company was owned by the defendant, San Joaquin Electric Company; that it bought that entire property with $165,000 of its bonds.

Record pp. 227, 228, 229.

Therefore, the amount of money that the San Joaquin Electrc Company received from the Fresno Water Company could not create an indebtedness from the former to the latter, but was simply that much money received by the Electric Company that actually belonged to it. In other words, it should have been given as one of its receipts, instead of one of its debts.

These are the figures with respect to the financial condition of the Company at the time mentioned. No evidence is given to dispute them. No excuse for not applying this money to

the payment of the interest due is attempted to be shown. That the revenues of the Company have since increased, so that it is not only able to pay its interest, but all of its accrued and accruing debts out of its earnings, is an admitted fact. Indeed, it was broadly admitted by counsel on the other side at the argument in the court below that the Company was now solvent, and that it could pay not only the interest accruing, but within a short time the accrued and overdue interest. This being so, there must be something behind this foreclosure other than an honest effort to recover for the bondholders the money thus owing. This brings us to the next proposition.

III.

Was there, or is there now, any necessity for the foreclosure of the trust deed for the protection of the bondholders?

This proposition really needs no discussion. The revenues of the Company were increasing so rapidly before the interest had been due six months, that it must have been perfectly evident to any unbiased mind that the bondholders were perfectly secure, and would receive their interest without unreasonable delay. When the Company had a surplus of over $14,000.00 for the year that the interest fell due, and during the next year that surplus had increased to over $20,000.00, that should have been evidence enough to anyone desiring only to collect the money due to the bondholders that a foreclosure was wholly unnecessary. And the evidence shows that between the first day of January, 1899, and the first day of July of that year, Mr. Street, who was ostensibly acting for the majority bondholders, was in Fresno and investigated the condition of the Company. It is a significant fact that he went back to Chicago and told Mr. Coffin that the Company was solvent. That it was solvent there is no doubt, and Street

knew perfectly well, when he made that examination, and when the officers of the Company were making overtures to him for some share of the spoils in case of the reorganization, that this Company could, if it would, pay the interest before the end of the six months, and if he had wanted it, and demanded it, there is no doubt but that it could have been paid. But that was not what Street wanted. He could easily see that this was a valuable property, and as we shall show directly, negotiatons for a reorganization had commenced before the defalcation in the interest occurred at all, and within less than a month of that time the plan of reorganization had been prepared and practically agreed upon by the bondholders who were to participate in the benefits of the reorganization. But if this had not been so, the bad faith of the prosecution of these foreclosure proceedngs is made apparent now by reason of the fact that the evidence shows that since the foreclosure suit was commenced the revenues of this Company have run up to $80,000 a year, and that nearly $50,000 of that amount is surplus earnings after paying all of the operating expenses of the Company. $31,500.00 a year could be paid on the interest on the bonds as it fell due, and there would be nearly $20,000.00 of the surplus earnings to apply upon the back interest each year. With this showing, and the refusal of the complainant to suspend the prosecution of the case on our motion, it is made too clear for argument that the purpose of this prosecution is not to collect the money due the bondholders. This man Street is at the head of a wrecking company that engages in this reorganization business, and doubtless gets a large rake-off for its share of the spoils in bringing about the sacrifice of the property, by which the stockholders lose everything, and the bondholders get only a part of what is due them, and the American Sureties Company takes the balance. The bondholders we represent want nothing more

than their money. They do not want to become the stockholders of a reorganized company and take sixty per cent. of the amount of their present bonds drawing six per cent. in bonds of the reorganized company drawing only four per cent.; and when the Mercantile Trust Company persists in enforcing a foreclosure of a mortgage under these circumstances, it is simply acting in bad faith towards the bondholders, for all of whom it is trustee. Its simply duty is to make the money due the bondholders,—not to wreck the Company and sacrifice its property, or aid a part of the bondholders to reorganize the Company for their benefit. If the officers of this Company had, when it found itself unable to pay the semi-annual installment of interest, raised the rates for light and power, as it did after ths foreclosure suit was brought and the reorganization scheme all agreed upon, it would have had ample revenues with which to pay the interest within the six months. But that was not a part of the scheme. The first thing was to agree upon the reorganization and start the proceedings for foreclosure, and then make the property as valuable as possible for the benefit of the reorganizers. The whole scheme, from beginning to end, is a palpable fraud upon the right of all bondholders who are not seeking the reorganization, and it should not receive the aid of a court of equity, when the real facts are disclosed. And the Court can have no sort of doubt of the truth of these facts, and the bad faith of the whole proceeding, when it is considered that this man Street, who has been manipulating the whole thing, and was familiar with every fact and detail of the transaction, was not even called upon to testify. The testimony of Mr. Coffin connecting Street directly with the scheme to reorganize the Company, and that it was contemplated and talked about before any default in the interest at all, stands wholly undenied by Street, who could have disputed it if it was not true. The only claim they make with respect

to that matter is that the testimony is not competent, because Street's statement was only hearsay; but this is a mistake. It was not hearsay. Street, according to all the testimony, was acting for the bondholders who were charged in the bill in intervention with manipulating this property for the purpose of reorganization. What he said to Coffin was said directly in connection with and as a part of the negotiations then being carried on by him for that purpose. Therefore, his declaration was a declaration of a party in interest, and is not hearsay.

We need not enter upon a discussion of the figures or facts tending to show the present solvent condition of the Company. That it is now solvent and able to pay all of its debts, including the interest on its bonds, was admitted by counsel in the court below, and if it had not been admitted, it is shown by clear and undisputed testimony. So the evidence here shows that there was never any necessity for foreclosing this mortgage for the benefit of the bondholders, and that if there was at the time the suit was brought, the improved condition of the Company makes it unnecessary now; and there is no reason why this trustee should stand upon its strict legal right to foreclose this mortgage simply because there was a defalcation in one payment of interest, when it is clearly shown that it could get the money for the bondholders now without the foreclosure or sacrifice of the property.

IV.

Was there a plan or scheme to reorganize the company and foreclose the trust deed for the purpose, without regard to the necessity for such foreclosure for the protection of the bondholders?

We are impressed with the belief that no argument is necessary to convince the Court that there was a scheme for the

reorganization of this Company, or that the foreclosure of the trust deed is being prosecuted for the purpose of bringing about that reorganization. If this had not been so, they could have shown it without difficulty by taking the testimony of Mr. Street. All they do in that connection is to take the testimony of Mr. Deming, the vice-president of the complainant, Mercantile Trust Company, who testifies to nothing more than that he had no knowledge of any such reorganization scheme, or that the foreclosure was being brought for that purpose.

But his testimony shows that the Trust Company brought this suit simply because Street requested it to do so, and there is no evidence that Street had any authority from the majority of the bondholders to make such request; but conceding that he had, the fact still remains, as we shall show in a moment, that this reorganization scheme was conceived and entered upon before the default in the interest occurred, else Street would have been quick to deny it, and that the plan was all worked out and agreed upon long before this suit was brought. If we take the testimony of Mr. Coffin, it is quite convincing on that subject. He says in his testimony that he drew up a plan of reorganization early in January, 1899, and says, further:

"All the parties interested in the property were presented with the plan of reorganization which I drew up, *early in January*, 1899."

He gives the names of all of the persons taking part in the negotiations.

Record p. 155.

Street acted in person in these negotiations, representing other parties, and the others wer communicated with by letter.

Record p. 156.

He testifies distinctly that the first consultations over the

reorganization were held prior to the first defalcation in the interest.

Record p. 156.

And that the plan finally acted upon was prepared by Street, and was first contemplated in January or February of 1899.

Record p. 157.

And htat he, as one of the bondholders, received notice that the plan had been approved in London.

Record pp. 157, 158.

This plan of reorganization which he says Street informed him had been approved, is set out in his deposition at page 25, and is the same one set up in our bill in intervention and alleged to have been agreed upon by the parties.

Record p. 158.

Mr. Coffin testified further on this subject as follows:

"Q. Had you any conversation with Mr. Street in regard to this proposed plan of reorganization just shown you?

A. Yes sir.

Q. Was anything said as to whether or not that was presented to the bondholders in London?

A. Yes sir.

Q. Was anything said as to when it was presented to them?

A. Yes sir.

Q. When was it?

A. About the close of January or early in February, 1899. Mr. Street came here about January 20, 1899, and discussed my plan of reorganization, of which he expressed his entire approbation, but stated that he had been instructed by the London people, the American Sureties Agency, to proceed to Fresno and make a complete examination and report to London in person, if possible, which he did early in February, 1899."

Record p. 160.

Thus it is shown that the negotiations for the reorganization were entered upon prior to the default in the payment of the interest; that Coffin's plan was drawn and discussed between him and Street as early as January 20, 1899, or only

twenty days after the defalcation in the interest; that street was then on his way to Fresno to examine into the condition of the Company and report to the London people in person. The very fact that the transaction had gone thus far between Street and the London people, as early as January 20, 1899, is proof evident that they had considered this reorganization scheme before the interest fell due. Street did go to Fresno and make the examination, did report in person to the bondholders in London, and they did act upon this plan of reorganization as testified to by Coffin and not denied by anyone.

All of this occurred before the right to foreclose this mortgage accrued. Of course, no suit could be brought to foreclose the mortgage before the end of the six months, or July 1, 1899, and before that time came around, they had perfected their plans for the reorganization of the Company. Now, does this Court believe that if it had not been for this plan of reorganization so agreed upon between these parties, and considering the financial condition of the Company as it developed before the time for foreclosing the trust deed, that this foreclosure suit would ever have them brought for the sole purpose of recovering the amount due the bondholders? No, the court does not believe that the suit was brought, or is being prosecuted, in good faith by the people represented by Street. The Trust Company, the complainant, has simply permitted itself to be used by Street for his own purposes, without making any inquiries into the condition of things, which is the best that can be said for the Trust Company. But as for Street, whether the bondholders he represents are fully informed of the conditions or not, he has known for lo, these many months that the foreclosure of this trust deed was wholly unnecessary, and is without doubt prosecuting it for his own selfish ends.

V.

Were the officers of the company, or any of them parties to the scheme of reorganization?

It is perfectly evident that they were. The plan of reorganization itself shows that they were to have $100,000 of the capital stock of the reorganization company, provided they facilitated the foreclosure of the mortgage. That provision in the proposed plan of reorganization is as follows:

"Fourth—$100,000 of the capital stock will be insured to certain parties in Fresno for the water rights transferred by them to the old company, providing they facilitate the foreclosure of the mortgage."

Record p. 159.

The key to this provision in the plan of reorganization will be found in the testimony of Mr. Seymour, the president of the defendant company. He says:

"I will state that when Mr. Street was here in March or April, Mr. Eastwood and I, in a conference with him, after telling him that we knew no means by which the foreclosure proceedings could be prevented, the finances of the Company not materially improving, and the floating indebtedness being so much, we submitted to him as a matter of equity to put before the bondholders that we should be allowed—we asked that we be allowed some of the bonds of the new concern, in case of reorganization. We asked it as a matter of equity. That was the talk in our talk with him while here, asking him to present that to the bondholders as a matter of equity. We had devoted several years of our time here, and had worked at a very low salary, put in all our time at it, and we considered it a matter of equity. We considered it a good concern, and a matter of equity, we should have something in it along with the bondholders; and after he came back, he said that was the best he could do in the matter.

Q. Well, then, this proposal in the plan of reorganization grew out of that claim of yours that you should be allowed something?

A. Yes."

Record p. 273.

It should be remembered in this connection that before this

reorganization plan had been agreed upon, Street was endeavoring in Chicago to buy up the stock of the Company, as testified to by Mr. Coffin, with a view to reorganization. In that he seems to have failed. When he came on to Fresno, after seeing Mr. Coffin on his trip here to investigate and report to the people in London, he found that the officers and stockholders of the Company would have to be placated in some way, in order to bring them into line, and thus bring about the reorganization without opposition. This, it must be remembered, was long before the six months' defalcation had expired, and the testimony of Mr. Seymour is that at that time when he was here in March or April, he outlined in a vague way the plan of reorganization. He says:

"Q. When did you first hear anything about the proposed reorganization of this Company?

A. The first time I heard any definite statement in regard to taht matter was after we had defaulted six months on the bonds. I heard so in New York City. I saw that plan."

Record p. 270.

Here was the outcome of the previous claim made by Seymour and Eastwood that they should be allowed something in the reorganization. As the result of that claim, this clause referred to above, allowing them $100,000 of the stock of the reorganized company, was inserted in the plan, but upon the condition that these officers of the Company should facilitate the foreclosure. So the officers of the Company knew of the proposed reorganization long prior to the time when they might have paid the interest and prevented a foreclosure, and were resting upon their claim that they should have something in the reorganization, and with the promise of Street that he would do the best he could for them. Here they were placing themselves in an attitude antagonistic to their duties towards other stockholders. The very fact that they expected to participate in the reorganization to the exclusion of other

stockholders was a strong inducement to them to do just what this proposed plan required them to do, viz: facilitate the foreclosure; and when Mr. Seymour went to New York, this plan of reorganization was all prepared and agreed upon, and submitted to him. It may be important here to fix the exact time when Mr. Seymour went to New York. This is shown by a letter written by Mr. Collier, the secretary of the Company, to Mr. Coffin, and set out in his deposition. The letter bears date July 11, 1899, and will be found in Mr. Coffin's deposition at page . In this letter he says, in substance:

"Mr. Seymour is now in New York, called there by telegram from Mr. Street."

Record p. 153.

If Seymour was in New York on the 11th day of July, he must have been called there before or immediately after the six months within which the interest might have been paid had expired, and upon his going there, he was confronted with this plan of reorganization drawn up and agreed upon, in which he was to share in the benefits of the reorganization. Street not only submitted this plan of reorganization to him, but offered him the receivership during the foreclosure as a direct bribe for not opposing the foreclosure. His testimony on that point is as follows:

"Q. Were you asked at that time by Mr. Street or anyone else, to go into that plan of reorganization?

A. He made a proposition to me that he would ask to have me appointed received if I would make no formal defense or defenses as a stockholder or as president of the Company, against the foreclosure proceedings, and I declined to do so. Afterwards, he made a proposition that he would have the Mercantile Trust Company act, asking that I be appointed receiver, if I would agree to conduct it on ordinary business principles(and so I went in with no obligation whatever.

Mr. Corey—The only thing was that you would not charge more than a certain price?

A. Yes, my salary would not be more than a certain amount, providing the Judge granted me more than that as re-

ceiver. His idea was not to load it up with undue receiver's salary.

Mr. Works—Was that matter of reorganization ever taken up and acted upon by the local stockholders here?

A. It never was.

Q. Was any consent ever given by any of the local stockholders to tha or any other plan of reorganization?

A. Not that I know of.

Q. How much of the stock did you own at that time?

A. I owned a little over a quarter.

Q How much did Mr. Eastwood own?

A. The same amount.

Q And he and you together owned a controlling interest in the stock at that time?

A. Yes sir.

Q. And is that the condition at the present time?

A. It is."

Record p. 271.

There is no question, under this testimony, as to Street's bad faith. He was making a direct proposition to the president of this Company to buy him up for 100,000 shares of the stock of the re-organized company, not to make any defense to the foreclosure. Mr. Seymour says he declined to accept that proposition, but he did accept the receivership, and he did cause the company to enter its appearance in this case, admitted all the facs alleged in the bill, including the allegation that his Company was insolvent, and stipulated for his appointment as receiver of the Company during the litigation, and the decree of foreclosure would have followed without any defense having been made if the entervening stockholders had not interposed for their protection.

These are the facts as Mr. Seymour's own estimony discloses them. He knew perfectly that he was expected not to make this defense, and that he would, if he did not make the defense, receive, with Mr. Eastwood, the hundred thousand shares of the stock of the reorganized company, and Street knew it. Under such circumstances, a court of equity should

not be found aiding Mr. Street or the people he represents to foreclose this trust deed, and thus carry out a scheme conceived in iniquity and for the very purpose of wrecking this Company and sacrificing its property, and getting it into the hands of the reorganizers, leaving out the bondholders we represent, who, according to their testimony, were not consulted with respect to this reorganization, and received no notice of the purpose to bring it about. The only thing in the whole estimony relating to this question that would shield Mr. Seymour from the charges made that he was allowing himself to be used for the purpose of bringing about this foreclosure, is his bare statement that when the proposition was made to him he declined it. The evidence from beginning to end is consistent with the charge made, and wholly inconsistent with his innocence of an intention to bring about exactly that result, and save for himself his proportion of the 100,000 shares of stock in the new company; and nobody knew better than Mr. Seymour the value of those shares of stock, with the growing revenues and increasing value of the property of the Company. And when we consider the fact that the first proposition that Seymour and Eastwood should have some of the spoils of this reorganization came from Seymour himself, as early as March or April, 1899, and long before the six months had expired within which the interest could be paid, and the property saved from the foreclosure, it is conclusive evidence that the officers of the Company were not free handed and untrammelled in the performance of their duties towards the other stockholders, and the bondholders, with respect to thé litigation. We submit that upon this ground alone, the bill should have been dismissed; and if these bondholders can not get their interest under existing circumstances, let them bring their suit over again. The hardship would be none too great as a penalty for the course they have taken in this whole business. But we

have not asked even this of them. By our motion presented in connection with the hearing, we asked that the receiver be instructed to apply the surplus revenues that the Company is now making to the payment of the back interest, until the whole amount is paid. (Record p. 318.) Mr. Seymour, in his testimony, estimated that with the present revenue of the Company, which will doubtless increase, the whole thing could be cleared up inside of three years. The figures really show that it could be done in much less time. If the trustee and the bondholders who are threatening this foreclosure were acting in good faith, they would accept this proposition at once. It would bring to the test without delay the question as to whether the earning capacity of this Company is sufficient to make the payment of their interest sure. If it would, they have no reason to complain. Having refused t, there is every reason why the intervening bondholders here should be let in to protect their own interests, and that the decree appealed from should be reversed.

VI.

Did such officers, in view of such proposed re-organization and the benefits to accrue to them thereby, allow the continued defalcation of more than six months, when they could have avoided it by paying the semi-annual interest charge maturing on January 1, 1889, *and which might have been paid at any time before July* 1, 1899, *and the foreclosure thereby prevented?*

The quesion here presented has been answered by what has already been said. The evidence shows conclusively that the officers *could* have paid the interest within the six months, if they had desired to do so. That we have demonstrated by the figures set out above. Instead of doing so, they entered upon negotiations with Street, when he was here, in March or April,

to procure some of the spoils of the reorganization. According to he testimony of Mr. Seymour, they asked for some of the bonds. In the plan of reorganization they were allowed some of the stock, on condition that they should make no defense to the foreclosure. They did not pay the interest, as they could have done. They did not defend he foreclosure suit, as it was their duty to do, and they had held out to them and understood that they were to receive $100,000 in shares of the stock of the new corporation if they did not make the defense. Here are the facts. They are unanswerable. There has been no attempt to answer them by the testimony of the complainant. They simply asked the Court below to ignore these facts, and hold that they were entitled to the foreclosure of this trust deed on the purely legal ground that the interest having remained unpaid for six months, they were entitled to foreclose. But this will not do. The complainant, as a trustee, owes a duty to all of the bondholders secured by this trust deed. That duty is to collect the money due them—not to reorganize the Company. Here it is demonstrated that the money can be collected without doubt, without the foreclosure. It was demonstrated both to the Court below and to the trustee that the object and purpose of the foreclosure is the reorganization of the Company, and not to recover the money due to the bondholders. This should be enough to prevent the foreclosure. This is a court of equity, dealing with the acts of a trustee. The trustee should not be permitted by the Court to vary from its strict duty as such trustee. The minority bondholders have the same right to be protected that the majority bondholders have. It is as much the duty of the trustee to protect them as it is to protect the majority bondholders, and whenever it was disclosed to the trustee that this trust deed was being foreclosed, and it was being used for the purpose of foreclosing this mortgage, not for the purpose of collecting

the money, but for the purpose of reorganization, it should have dismissed its bill without being compelled to do so by the Court. Not having done so, the Court should act for the trustee, and order the dismissal of the bill. We submit that the case is clear and conclusive under the evidence, and that the bondholders we represent here are entitled, as a matter of equity, to have the decree reversed and the bill dismissed, so that they may receive their money.

Respectfully, submitted.

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